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Supreme Court,
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1936

No. 139.

THE PEOPLE OF THE STATE OF NEW YORK upon the relation of RICHARD REID ROGERS,

Appellant,

vs.

MARK GRAVES, JOHN J. MERRILL and JOHN P. HENNESSEY, as Commissioners constituting the State Tax Commission of the State of New York,

Appellees.

BRIEF FOR RELATOR-APPELLANT

RICHARD REID ROGERS,
Relator and Appellant, Pro Se.

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BRIEF FOR RELATOR-APPELLANT.

Statement.

This case, a test case, involves the question of the exemption from State income taxation of the salaries of the officers of the Panama Rail Road Company, a United States Government agency employed in the construction, operation and maintenance of the Panama Canal. As the case was decided in the Appellate Division it also necessarily involves the immunity of the Panama Rail Road Company itself from State taxation.

The case comes up specifically upon the salary paid the relator as general counsel for the company for the years 1927, 1928 and 1929. This salary was reported in the rela-

tor's State income returns for those years, but no tax was currently paid, upon the ground that the salary was exempt. The tax, having been subsequently imposed by the State Tax Commission, was paid under protest, and a writ of certiorari sued out in the Appellate Division of the Supreme Court of New York. In the Appellate Division the constitutional point of immunity raised by the relator was overruled and the tax sustained upon the ground that the Panama Rail Road Company engaged in certain commercial activities. On a subsequent appeal to the Court of Appeals where the same point was raised the case was affirmed without opinion (271 N. Y. 39).

Before the State Courts, the relator contended: (1) that the Panama Rail Road Company was a wholly owned instrumentality of the United States Government, employed in the maintenance, operation and protection of a work of national importance, to wit: the Panama Canal; (2) that as such instrumentality the Panama Rail Road Company was exempt from State taxation; and (3) that the Railroad Company being so exempt, the fixed salaries paid to its officers and employees were likewise exempt.

None of these points was contested in the opinion of the Appellate Division; apart from the fact that the Appellate Division held that the Panama Rail Road Company was not engaged in the conduct of an essential or useful governmental function and, therefore, possessed no immunity. This is the principal question which will be discussed on this appeal; but as preliminary to this discussion the authorities and evidence which support the relator's postulates will previously be presented.

Specification of Errors.

1. The Court of Appeals erred in affirming the order and judgment of the Appellate Division of the Supreme Court holding that the New York State income tax law, in so far as it authorized the taxation of the annual salary paid by the Panama Rail Road Company to the appellant, was valid

—the Constitution of the United States and particularly Article 1, Section 8 thereof, to the contrary notwithstanding.

2. The said Court erred in failing to render judgment in favor of the appellant.

3. The said Court erred in affirming the holding that the Panama Rail Road Company, even though an instrumentality of the United States Government, had forfeited its immunity from State taxation because it engaged in certain commercial activities; and that the salaries paid its essential officers, including the annual salaries paid the appellant for the years 1927, 1928 and 1929, were therefore subject to State income taxation.

4. The said Court erred in not holding that such commercial activities, even if conducted at a profit, were only incidental to the main purpose of the Panama Rail Road Company as an adjunct of the United States Government in carrying on the work of construction, maintenance and protection of the Panama Canal, which main purpose was within and not a departure from the usual governmental functions of the United States.

Jurisdictional Question.

The respondent moved to dismiss the case for lack of jurisdiction in this Court upon the ground that the relator might possibly have been an independent contractor rather than an officer of the Panama Rail Road Company, and that the decision of the Court of Appeals might possibly have rested on this ground. During the course of the oral argument when this point was raised (the Attorney General in his motion to dismiss admits the "question was not strenuously urged") the following colloquy took place: Judge Lehman: "You do not wish the case decided on that ground, do you?" Mr. Mesnig, Assistant Attorney General for New York: "No, sir, we want a decision upon the merits." Naturally so,

inasmuch as the case was a test case involving the salaries of all other officers of the company, and a decision upon a special point would not have settled the main controversy.

However, it is not true, as contended, that the record is silent on the subject, for it definitely appears that the relator "is and has been for many years an officer, to wit, General Counsel, of the Panama Rail Road Company under a fixed salary per annum" (fol. 71), and that there was no other compensation outside of the salary (fol. 49). It is difficult to see, moreover, why the constitutional question was not involved even if the Attorney General's point were sound, for there would still arise the fundamental questions whether the State could tax any compensation paid by a Federal instrumentality to an essential officer, or whether the salary was not in substance a governmental salary.

I.

The Panama Rail Road Company is an instrumentality of the Government of the United States.

This point is no longer contested. Nevertheless the decisions, laws and documents which support the caption should be referred to for the convenience of the Court.

In *United States ex rel. Skinner & Eddy Corporation* v. *McCarl*, 275 U. S. 1, 6, this Court had occasion to review the private corporations then employed as Government instrumentalities, some of which had been incorporated under State laws. Referring to the Panama Rail Road Company, this Court said:

> "For many years before the war the Government had employed the Panama Rail Road Company as its instrumentality in connection with the Canal."

In the footnote to this decision reference was made to a letter of Mr. William H. Taft, then Secretary of War, and as such officially in charge of the Canal, transmitting the first report of the Isthmian Canal Commission, under date

of December 1, 1904 (p. 14). After referring to the acquisition from the French Canal Company of practically all the stock of the Railroad Company—an ownership shortly thereafter made complete (Rec., fol. 73)—the Secretary says:

> "The United States purchased the shares in the company for the purpose of using the railroad to assist it in the construction of the canal, and it is quite evident that this purpose will be largely defeated unless the representatives of the United States may use the railroad without let or hindrance in canal construction. Of course, under the franchise authorizing the operation of the railroad company, there is an obligation upon those who run the railroad and use the franchise to perform the duty of a common carrier. It is entirely feasible fully to perform such a duty and still to use the railroad as an auxiliary instrument in the construction of the canal."

This Court also referred to the annual report of the Panama Rail Road Company for the year 1904 (p. 9), where was quoted the report of the Interstate and Foreign Commerce Committee of the House of Representatives upon the Panama Rail Road Company, dated March 3, 1902, as follows:

> "The successful construction of the Panama Canal demands that the United States shall own and operate the Panama Railroad. In doing this, however, neither its earning capacity nor its efficiency as an artery of commerce should be impaired."

Further reference may be made to the following Acts of Congress and executive orders:

The United States Government having finally decided upon the construction of an isthmian canal, Congress passed the Act of June 28, 1902 (32 U. S. Stat. 481), appropriating $40,000,000 for the acquisition of all the property, concessions and rights of the French Canal Company in Panama. The purchase, as consummated, included substantially all the stock of the Panama Rail Road Company. Thereafter our Government acquired rights to the Canal Zone across

the Isthmus from the newly-created Government of Panama; and the President, Mr. Theodore Roosevelt, to whom was entrusted by Congress all powers relating to the execution of the enterprise, laid down instructions for its administration in a letter to the Secretary of War which possesses the importance of a charter. He said (fol. 97):

> "By virtue of the ownership by the United States of about sixty-nine seventieths of the shares of the capital stock of the Panama Railroad the general policy of the managers of said road will be controlled by the United States. As soon as practicable I desire that all the members of the Isthmian Canal Commission be elected to the board of directors of the road, and that the policy of the road be completely harmonized with the policy of the Government of making it an *adjunct* to the construction of the canal, at the same time fulfilling the purpose for which it was constructed as a route of commercial movement across the Isthmus of Panama."

By Section 2 of Act of Congress approved August 24, 1912 (37 Stat. 560-569), commonly known as "The Panama Canal Act," all orders, regulations and ordinances with respect to the Panama Canal promulgated by the President were ratified and confirmed. Moreover, by Section 6 of the same Act it was specifically provided as follows:

> "The President is also authorized to establish, maintain and operate, through the Panama Railroad Company or otherwise, dry docks, repair shops, yards, docks, wharves, warehouses, storehouses, and other necessary facilities and appurtenances for the purpose of providing coal and other materials, labor, repairs, and supplies for vessels of the Government of the United States, and, incidentally, for supplying such at reasonable prices to passing vessels, in accordance with appropriations hereby authorized to be made from time to time by Congress as a part of the maintenance and operation of the said canal. Moneys received from the conduct of said business may be expended and reinvested for such purposes without being covered into the Treasury of the United States; and such moneys are hereby appropriated for such

purposes, but all deposits of such funds shall be subject to the provisions of existing law relating to the deposit of other public funds of the United States, and any net profits accruing from such business shall annually be covered into the Treasury of the United States."

The following additional Acts, bearing upon the public status of the Panama Rail Road Company and showing how closely the railroad and steamship line and its employees are identified with the Government, may be cited:

By Act of Congress approved March 4, 1907 (34 Stat. 1368-1371), the Congress appropriated $2,298,367.50 to pay for the outstanding 4½ percentum mortgage bonds of the Panama Rail Road Company.

By Act of Congress approved May 27, 1908 (35 Stat. 384, 387), the Congress appropriated (1) $1,550,000 to enable the Secretary of War to purchase two steamships for the Panama Rail Road Company; (2) $1,100,000 to continue the equipment and construction of the Panama Rail Road; and (3) made the general appropriation for the Panama Canal available to reimburse the Panama Rail Road Company for marine losses or for losses due to destruction of or damage to its plant, equipment or commissary supplies by fire.

By Act approved March 4, 1911 (36 Stat. 1449), the Congress stipulated that the Panama Rail Road Company should not be required to give bond in any contracts it might make to furnish services, material or supplies to the Army, Navy or Marine Corps or other departments of the Government.

By Act of Congress approved March 4, 1909 (35 Stat. 1024, 1027), the Congress appropriated (1) $1,980,000 for the relocation of the Panama Rail Road; and (2) continued the appropriation to reimburse the Panama Rail Road Company for marine and fire losses.

By Act of Congress approved June 25, 1910 (36 Stat. 771), the Congress appropriated (1) $2,000,000 for the relocation of the Panama Rail Road; (2) continued the appropriation to reimburse the Panama Rail Road Company for marine and fire losses; and (3) cancelled the obligation of

the Panama Rail Road Company to pay to the United States, as successor to the rights of Colombia and Panama, the annual subsidy of $250,000 required to be paid by the Panama Rail Road Company to Colombia under the original concession.

By Act of Congress approved March 4, 1911 (36 Stat. 1449), the Congress directed (1) that the Panama Rail Road Company should carry no insurance to cover marine or fire losses; and (2) make no further payment upon the principal or interest on notes theretofore given by it to the United States for moneys appropriated for its use; such moneys representing the funds advanced for the retirement of the company's 4½ percentum bonds.

By Act of Congress approved August 24, 1912 (37 Stat. 560-569), the President was authorized to determine and adjust all personal injury claims in connection with the construction, maintenance and operation or sanitation of the canal or of the Panama Rail Road Company.

By Act of Congress approved July 1, 1916 (39 Stat. 332-334), the Congress appropriated funds for the purpose of reboilering the steamers *Ancon* and *Cristobal* belonging to the Panama Rail Road Company.

By Act of Congress approved September 7, 1916 (39 Stat. 742-750), the Congress, having provided a scheme of compensation for injuries sustained by employees in the Government service and having appropriated public funds for the payment of such compensation, specifically defined the term "employee' under the Federal Compensation Act to include "all civil employees of the * * * Panama Rail Road Company."

By Act of Congress approved August 1, 1914 (38 Stat. 674, 679), the Congress provided for the consolidation of the functions of receiving, disbursing and accounting for the funds of the Canal Zone Government and the Panama Rail Road operations on the Isthmus with the functions of receiving, disbursing and accounting for the funds appropriated for the Panama Canal.

By Act of Congress approved May 14, 1928 (45 Stat. 532), the Treasurer of the United States was authorized and di-

rected to cancel and surrender to the Panama Rail Road Company the notes given to the United States prior to 1911, with respect to which payment of interest and principal had been discontinued by Section 2 of the Act approved March 4, 1911.

By Act of Congress approved March 2, 1931 (U. S. Code, 1935, Title 48, Secs. 1371 *et seq.*), the Congress provided for a compensation and retirement system, toward which United States public funds were contributed, for "all employees of the Panama Canal on the Isthmus of Panama, and all employees of the Panama Rail Road Company, on the Isthmus of Panama, who are citizens of the United States and whose tenure of employment is not intermittent nor of uncertain duration."

In the Temporary Economy Act of June 30, 1932 (being Part II of the Legislative Appropriations Act for 1933, 47 Stat. 399), the Government provided for a compulsory furlough without salary of all Government employees for the fiscal year ending June 30, 1933. The term "officer" or "employee" in Section 104 of the special Act was defined to mean "any person rendering service in or under any branch of service of the United States Government." Under a permissive privilege contained in Section 101 of the said Act, the President of the United States, under an order dated July 25, 1932, provided, in the case of the Panama Rail Road Company, for an equal distribution of the enforced furlough without pay through the twelve months of the year, thus in effect reducing their monthly pay and salaries by 8⅓ percentum per month (fol. 78).

In both the Temporary Economy Act (Sec. 108, 47 Stat. 402) and the later Economy Act (by cross-reference in Sec. 4, 47 Stat. 1513) it was provided as follows:

> "*Government Corporations*
>
> Sec. 108. In the case of a corporation the majority of the stock of which is owned by the United States, the holders of the stock on behalf of the United States, or such persons as represent the interest of the United States in such corporation, shall take such action as

> may be necessary to apply the provisions of sections 101, 102, 103, 105 and 107 to offices, positions, and employments under such corporation and to officers and employees thereof, with proper allowance for any reduction in compensation since December 31, 1931."

The importance attached to the steamship line of the company is illustrated by the various department rulings:

Under date of March 28, 1927, a question having arisen as to the advisability of abandoning the line of steamships owned and operated by the Panama Rail Road Company connecting the Panama Canal with the continental United States, and substituting therefor service to be supplied by private corporations, and the matter having been referred to the chief co-ordinator, General Smithers, the latter, in a communication to the Shipping Board, advised against the abandonment of the steamship line, as follows (fol. 104):

> "No establishment of Government dependent upon shipping for the fulfillment of its mission in Government may with impunity be placed in a position of forced dependence upon shipping that is less sensitive to the pressure of its own dispensing authority than are the vessels operated in its own service; nor may it safely be forced into dependence upon vessels whose movements are less responsive to the orders or desires of its own dispensing authority than are vessels operated directly under its own command."

In a letter to the President of the United States, dated April 27, 1928, the then Secretary of War, Mr. Davis, dealing with the same subject, declared (fol. 113):

> "The line is an integral part of the Panama Canal and indispensable in its discharge of its normal responsibilities. The successful operation of this great enterprise, which is of vital importance to the United States, demands absolute security as to its line of supply to this country."

The position of the Secretary of War was approved by the President of the United States; and the policy thus out-

lined has been continued by all other Secretaries of War, through whose department the operation of the Panama Rail Road Company is controlled (fol. 82).

The War Revenue Act of 1917, Section 500 (40 Stat. 314), provided for a tax of 3 percentum upon the amount paid for transportation by rail and water. It further provided, in Section 502, as follows:

> "No tax shall be imposed under section 500 upon any payment received for services rendered to the United States or any State, Territory, or the District of Columbia. The right to exemption under this section shall be evidenced in such manner as the Commissioner, with the approval of the Secretary, may by regulation prescribe."

The question whether transportation services rendered to the Panama Rail Road Company would be subject to the tax mentioned having been referred to the Commissioner of Internal Revenue, the Internal Revenue Commissioner, under date of March 11, 1918, ruled as follows (fol. 122):

> "In reply, you are advised that payments made from the treasury of the United States for transportation or other services are exempt from the tax, and as payments for services rendered the Panama Rail Road Company are in substance payments for services rendered the United States, under the provisions of section 502 of the Act they are exempt from the tax."

The above provisions as to tax on transportation services were repeated without substantial change in Section 500 of the Revenue Act of 1918 (40 Stat. 1101), Section 502 of the Act of 1917 becoming 500(h) of the Act of 1918 (40 Stat. 1102). By Treasury Department Regulations No. 49, referring to these provisions in the Act of 1918, it was provided as follows (Corporation Trust War Tax Service, 1919) (fol. 124):

> "Article 70. Government Agencies. Transportation services rendered to agencies of the United States are exempt from the tax. Such agencies include the American National Red Cross, United States Shipping

> Board Emergency Fleet Corporation, United States Food Administration Grain Corporation, United States Fuel Administration, United States Housing Corporation, Commission on Training Camp Activities, War Savings Committee, Liberty Loan Committee, War Industries Board, Federal Farm Appraisers, Federal land banks, Federal reserve banks, *Panama Railroad Co.*, and similar agencies supported by Government funds."

A question having arisen as to whether the Panama Rail Road Company was subject to Capital Stock Tax imposed by the Federal Government under Section 1000 of the Revenue Act of 1918 (40 Stat. 1126), the matter was referred to the Commissioner of Internal Revenue, at Washington, and the company was advised as follows (fol. 128):

> "Kindly inform this office of any provisions in the corporation's charter or of any existing agreement involving the liability of your company for taxes.
>
> In the absence of such requirements it would appear that the Panama Rail Road Company is a Government agency and is not liable for Capital Stock tax. If this assumption is correct, you are at liberty to file claim for refund of $14,896 amount of tax paid, using the enclosed form, and stating full particulars."

A question having arisen whether the Panama Rail Road Company was subject to Federal income taxes, the matter was again referred to the Commissioner of Internal Revenue, and under date of September 20, 1926, the Panama Rail Road Company was advised as follows:

> "It appears that you are a domestic corporation and that under the authority of section 1 of the Isthmian Canal Act of June 28, 1902, the United States acquired your entire capital stock. It further appears that for the purposes of the tax imposed by section 500 of the Revenue Act of 1917, it was held that you were an agency of the United States Government.
>
> Inasmuch as you are a governmental agency you are not required to file Federal income tax returns or to pay Federal income taxes."

II.

If the Panama Rail Road Company is exempt from State taxation, the fixed salaries paid its employees are likewise exempt.

Neither is this point contested in the opinion of the Appellate Division, nor heretofore by opposing counsel in his various briefs; the argument being that the Panama Rail Road itself is not exempt.

The fundamental doctrine that the instrumentalities of the Federal Government are exempt from State taxation being conceded, the corollary, that the income derived from such instrumentalities is also exempt, has thus been laid down by the Supreme Court:

In *Gillespie* v. *Oklahoma,* 257 U. S. 501, 505, this Court held that the lessee under oil leases of Indian lands, made by the United States in carrying out its duties towards the Indian tribes, was an instrumentality employed by the Government (p. 504), and that the income derived by the lessee from the leases could not be taxed as part of the lessee's income under the State income tax law of Oklahoma. The Court said: "In cases where the principal is absolutely immune from interference, an inquiry is allowed into the sources from which net income is derived, and if part of it comes from such source the tax is *pro tanto* void." * * * "If the property is exempt, the income from it is also exempt" (p. 505).

The same principle was restated in *Metcalf* v. *Mitchell,* 269 U. S. 514, 522:

> "Just what instrumentalities of either a state or the Federal government are exempt from taxation by the other cannot be stated in terms of universal application. But this court has repeatedly held that those agencies through which either government immediately and directly exercises its sovereign powers are immune from the taxing power of the other, * * *

> and when the instrumentality is of that character, *the immunity extends not only to the instrumentality itself but to income derived from it.*" (Italics appellant's.)

There are many illustrations of this principle to be found in the reports. A few of the most pertinent, in addition to the leading case of *M'Culloch* v. *Maryland*, 4 Wheat. 316, hereafter discussed, will be referred to.

In *Weston* v. *Charleston*, 2 Pet. 449, the Constitution having delegated to the Congress the power to "borrow money," it was held that "stock," i. e., bonds, of the United States held by citizens of South Carolina could not be taxed.

In *Pollock* v. *Farmers Loan & Trust Co.*, 157 U. S. 429, 584, 601, 652, s. c., 158 U. S. 601, 618, 693, it was held, the full court agreeing upon this point (see *Evans* v. *Gore*, 253 U. S. at p. 255), that municipalities being agents of the State, the Federal Government could not levy an income tax upon the interest received by private investors from municipal bonds.

In *Macallan Co.* v. *Mass.*, 279 U. S. 620, the doctrine of the foregoing case was further extended to holding unconstitutional an excise tax proportioned to income levied on corporations for the privilege of doing business, to the extent that any portion of such tax was measured by income received from Government bonds.

In *Dobbins* v. *Commissioners of Erie County*, 16 Pet. 435, 448, a revenue cutter being held to be an instrumentality of the United States, it was further held that the master thereof could not be taxed for county rates upon the value of his position. The argument of the Supreme Court, very applicable here, was as follows:

> "Is the officer, as such, less a means to carry into effect the great objects than the vessel which he commands, the instruments which are used to navigate her, or than the guns put on board to enforce obedience to the law? These inanimate objects, it is admitted, cannot be taxed by a State, because they are means. Is not the officer more so, who gives use and efficacy to the whole? Is not compensation the means

> by which his services are procured and retained? It is true it becomes his when he has earned it. *If it can be taxed by a State as compensation, will not congress have to graduate its amount, with reference to its reduction, by the tax?"* (Italics appellant's.)

In *California* v. *Pacific Railroad Co.*, 127 U. S. 1, 41, the Pacific railroads having received franchises to construct and operate continental roads from the Government of the United States, it was held that the State of California could not include their franchises in a valuation of railroad property for purposes of taxation.

In *Burnet* v. *Coronado Oil & Gas Co.*, 285 U. S. 393, the converse of the proposition laid down in *Gillespie* v. *Oklahoma, ubi supra,* was affirmed by the Supreme Court. It was there held that the Federal income tax could not be applied to income derived by lessees from oil leases of State school lands.

In *Panhandle Oil Co.* v. *Miss.*, 277 U. S. 218, it was held that the State gasoline tax could not be collected from private sellers on gasoline sold to the United States for use of its coast guard fleet and veteran's hospital, the court saying that a State may not lay a tax on sales by which the United States "secures the things desired for its governmental purposes." This doctrine was later extended to a gasoline "storage" tax: *Graves* v. *Texas Co.*, decided May 18, 1936.

In *Indian Motocycle Co.* v. *United States*, 283 U. S. 570, the complement of the foregoing proposition was applied in the case of sales to a State agency. It was there held that the Federal excise tax of five percentum (5%) on the price of motor vehicles could not be applied to sales to the police force of a State municipality.

Finally, "where the principle applies it is not affected by the amount of the particular tax or the extent of the resulting interference, but is absolute" (*Indian Motocycle Co.* v. *United States*, 283 U. S. at p. 575).

This principle seems to be recognized by the Supreme Court in the very latest case touching upon the subject: *Helvering* v. *Powers*, 293 U. S. 214.

III.

The immunity from State taxation of the Panama Rail Road Company as an instrumentality of the United States Government is not lost by reason of the fact that incidentally it engages in certain commercial activities.

The Attorney General for New York, supported by the opinion of the Appellate Division, contends to the contrary; and the proposition stated in the caption thus becomes the focal point of argument in this Court.

The Appellate Division deals with the Panama Rail Road Company as though it were a Government-controlled agency engaged *solely* in commercial operations. It is the fault of this opinion that it disregards the truly governmental functions which the Panama Rail Road Company discharges and looks only to certain commercial activities which are in fact subordinate to the main purpose of the company.

It is seldom that a governmental agency will be found to be exclusively such. The point is well illustrated by the following excerpt from the decision of this Court in *Emer. Fleet Corp.* v. *Western Union*, 275 U. S. 415, 424, where it was held that the Fleet Corporation was entitled to governmental telegraph rates although competing with private shipping.

> "The conduct of business in competition with private interests may of course be for a public purpose, Standard Oil Co. v. City of Lincoln (post, p. 504). Other departments which compete with private business have long enjoyed the government rate without question. The post office has since 1872 competed with bankers through money orders; since 1910 with savings banks by receiving deposits on interest; since 1913 with express companies through the parcel post. The War Finance Corporation has since 1918 competed with private bankers. The War Department has by its Mississippi River barge lines competed since 1920 with the railroads. Equally with all of these, the Fleet Corporation is acting for and on behalf of the United States."

The test of this much-debated question, it seems to this relator, is not whether the governmental agency, in the course of its operations occasionally does those things which ordinarily fall within the sphere of the private trader, but whether private trade is the *raison d'etre* for its existence. If so, the agency loses its immunity. But if its main or predominant purpose is governmental and its commercial activities merely incidental, it retains it. This proposition seems to be well supported by the decisions of this Court.

The commercial activities referred to by the Appellate Division are the operation of steamships, railroads, stores, hotels and dairies.

It is true that the company operates a line of steamers between New York and the Canal Zone; but the maintenance of this line is not for the primary purpose of engaging in commercial competition with other lines. The steamship line is maintained under a policy of many years' standing "for the purpose of maintaining an independent and wholly-controlled line of communication between the United States and the Canal Zone" (fols. 75, 56). It affords a concession to the Government of 25 percentum from tariff rates; and, in the interest of all Government employees on the Isthmus, whose health requires annual vacations to northern climes, transports those employees between the Isthmus and the United States at as low a rate as $20 per passage, much less than the actual cost. It likewise assures the proper provisioning of the Canal. The greater portion of its services is taken up with these functions. It is operated at a deficit (fols. 57, 58). It is the policy of the Government to control this line of communication. As said by the Secretary of War in the passage quoted above:

> "It is an integral part of the Panama Canal and indispensable in its discharge of its normal responsibilities. The successful operation of this great enterprise, which is of vital importance to the United States, demands absolute security as to its line of supply to this country" (fol. 113).

It is true that it accepts outside freight and passengers to the limited extent that its ships afford (fol. 57); but surely the Government cannot be criticized for seeking to diminish its losses incurred in an essential governmental undertaking by charging for certain services which are wholly incidental to the main purpose. If it were otherwise, a premium would be placed on inefficiency; and only those agencies which were badly managed and run at a loss would preserve their tax immunity. The Panama Canal itself, which charges tolls, in this aspect would lose its immunity. As said by this Court in a somewhat similar situation (*United States* v. *Chandler-Dunbar Co.*, 229 U. S. 53, 73):

> "If the primary purpose is legitimate, we can see no sound objection to leasing any excess of power over the needs of the Government. The practice is not unusual in respect to similar public works constructed by state governments." Cf. *Aswander* v. *Valley Authority*, 297 U. S. 288, 333.

The railroad also conducts a commissary department on the Isthmus. But this is for Governmental employees only, and was established so that the employees would not be at the mercy of the merchants of Panama and Colon (see letter of Mr. Taft transmitting his first report, cited by the Supreme Court, *ante*, p. 4). It is doubtful whether without such a commissary the Canal could be operated successfully at all. What is said of the commissary is true of the dairies and hotels.

As to the railroad: It is evident that the railroad was not only absolutely essential to the construction of the Canal but is also necessary to its continued maintenance and operation. Moreover, the railroad must always be held in reserve to provide against the contingency of accidental stoppage of the Canal.

But over and beyond this the maintenance of the railroad and the company itself is indispensable for other reasons. It was quite impossible for the Government, without disregarding its franchise obligations, to discontinue its opera-

tion. The concessionary contract of 1867 with Colombia, subsequently effective with respect to the Republic of Panama, provided for the perfection of the work of the railroad, "in order that it may better answer the necessities of the commerce of the world." See Bristow Report to Secretary of War, June 24, 1905, p. 323. Both President Roosevelt in his original order (*supra*) and Mr. Taft in his first report recognized this obligation. The latter said:

> "Of course, under the franchise authorizing the operation of the railroad there is an obligation upon those who run the railroad and use the franchise to perform the duty of a common carrier" (doc. cited above).

And that is what President Roosevelt doubtless referred to when in his charter letter cited above he spoke of the railroad "fulfilling the purpose for which it was constructed as a route of commercial movement across the Isthmus of Panama."

The Act of Congress of August 24, 1912 (commonly known as "The Panama Canal Act"), also specifically authorized the President "through the Panama Rail Road Company, or otherwise, to maintain dry docks, repair shops, docks, wharves and warehouses and other necessary facilities and appurtenances for the purpose of providing coal and other materials, labor, repairs and supplies for the Government and passing vessels at reasonable prices" (37 Stat. 560, 569). Without these facilities for transiting vessels it is hardly open to doubt that the Canal could not be successfully operated at all. But is the Panama Rail Road Company to be deprived of its immunity as a governmental agency *simply because it charges for this service?*

The question here involved, and, according to the decision below, the only important one in the case, seems to this relator to have been settled by the very first case involving the question which ever came before the Supreme Court of the United States—the great case of *M'Culloch* v. *Maryland*, 4 Wheat. 316. The State of Maryland undertook to tax the old Bank of the United States. The Bank of the United States, as is well known, was owned by private individuals;

it engaged in commercial banking, from which it derived profits and paid dividends; but this circumstance was not deemed to destroy its immunity from State taxation. This case settles the following propositions: (1) that in the choice of means to carry out its powers the Federal Government "may adopt any which were appropriate and which were conducive to the end" (p. 415); (2) that the employment of a corporation was an appropriate means (p. 409); and (3) finally that such instrumentalities as the Congress in its "discretion" chose to employ could not be taxed by the States. "The sovereignty of a state extends to everything which exists by its own authority, or is introduced by its permission; but does not extend to those means which are employed by Congress to carry into execution powers conferred on that body by the people of the United States" (p. 429). The conclusion was: "On just theory, a total failure of the original right to tax the means employed by the Government of the United States for the execution of its powers. The right never existed, and the question whether it has been surrendered cannot arise" (p. 430).

The doctrine of this case was reaffirmed in *Weston* v. *Charleston* (2 Pet. 449, 467), where it was declared that the right to impose such a tax "to any extent, however inconsiderable, is a burden on the operations of the Government" (p. 468).

In *Osborn* v. *United States Bank*, 9 Wheat. 738, 859, however, the precise point upon which this case was decided below was considered by the Supreme Court, and decided the other way. The argument, or rather reargument, there against tax exemption was that the Bank of the United States was an individual concern founded upon contract between individuals, "having private trade and private profit for its great end and principal object." But the Court overruled this argument upon the ground that the bank was "not considered as a private corporation, whose *principal* object is individual trade and individual profit; but as a public corporation, created for public and national purposes" (p. 860).

Thus was clearly recognized the distinction laid out above. But how much more true, than in the case of the old national bank, does the doctrine of predominant purpose apply to the Panama Rail Road Company, which is entirely owned by the Government itself, and is maintained and operated as a necessary "*adjunct*" in the operation, maintenance and even protection of the Panama Canal; and not primarily for the purpose of running a commercial railroad or steamship line or commissary in competition with other private interests; or for the sake of earning dividends! The phraseology employed in *Osborn* v. *United States Bank* exactly fits the case at bar.

What was true of the old national bank is likewise true of the numerous national banks created under the National Banking Law passed in 1864. These banks are all held in private ownership, are commercial enterprises and are run for profit. Yet without the consent of Congress they could not be taxed by the States even on their shares held in private ownership. That such consent was necessary is abundantly established by the cases of *M'Culloch* v. *Maryland*, 4 Wheat. 316; *Osborn* v. *Bank of the United States*, 9 Wheat. 738; *Weston* v. *Charleston*, 2 Pet. 449; *People* v. *Weaver*, 100 U. S. 539, 548; *Talcott* v. *Silver Bow County*, 139 U. S. 438, 440; *Owensboro National Bank* v. *Owensboro*, 173 U. S. 664, 668; *First National Bank* v. *Adams*, 258 U. S. 362; *Des Moines Bank* v. *Fairweather*, 263 U. S. 103, 106, 107.

Many other cases might be referred to as recognizing the principle that participation in commercial activities does not destroy the immunity from State taxation of a Federal agency. Reference will be made at this point to only one—The United States Emergency Fleet Corporation, which this Court has held to be a department of the United States Government (*Emergency Fleet Corporation* v. *Western Union Tel. Co., ubi supra*); and which is engaged almost entirely in commercial activities.

In *United States* v. *Coghlan,* 261 Fed. 425, 426, it was held that the property of this corporation was exempt from State taxation. The Court said:

> "It was shown that all the stock of the Fleet Corporation was owned by the government, and that all it did was done for government account, and that all the profits which it made would inure to the government, which would have to stand all the losses. Under such a state of facts, it is unnecessary to inquire whether for all purposes the Fleet Corporation is the Government. It suffices that it is a governmental agency, exclusively employed in governmental work, and as such its property is not liable to state taxation."

To the same effect was the decision of the Circuit Court of Appeals for the Ninth Circuit in *Kings County* v. *United States Emergency Fleet Corporation,* 282 Fed. 950; the Court observing:

> "If, taking a view most favorable to the defendants, but hardly warranted by the record, we assume the property was acquired with funds coming from the 'sale' of the capital stock of the Fleet Corporation to the Government, we would have a case where the Government, for its own convenience and for the more expeditious dispatch of public business, instead of acting directly through a recognized governmental department, brings into existence a new agency in the form of a private corporation, which it controls, and in which it holds all of the stock, and to which it contributes its entire capital."

Both of these cases were cited with approval upon this point by the Supreme Court in *Clallam County* v. *United States,* 263 U. S. 341, 345.

In passing it should be observed that the fact that the United States is the sole stockholder of the Panama Rail Road Company is a circumstance to which the Supreme Court has heretofore attached some importance. Thus, in *Railroad* v. *Peniston,* 18 Wall. 5, 32, the Court commented on the fact that the Government owned none of the stock

in the Pacific Railroad, whose property it was sought to tax; and in *Van Brocklin* v. *Tennessee,* 117 U. S. 151, 177, the Court commented on the foregoing circumstance. See also *Helvering* v. *Powers,* 293 U. S. at page 223.

The Appellate Division rested its conclusion on the doctrine of:

> *South Carolina* v. *United States,* 199 U. S. 437.
> *Ohio* v. *Helvering,* 292 U. S. 360.
> *Helvering* v. *Powers,* 293 U. S. 214.
> *Metcalf* v. *Mitchell,* 269 U. S. 514.

In the *South Carolina* case the Court was dealing with an excise tax, the power to levy which was specifically conferred upon Congress, and hence a power not to be limited by State action. The Court concluded:

> "Whenever a State engages in a business which is of a *private nature,* that business is not withdrawn from the taxing power of the nation."

The doctrine of this case was reaffirmed in *Ohio* v. *Helvering,* where the controlling principle was thus stated (p. 369):

> "If a State chooses to go into the business of buying and selling commodities, its right to do so may be conceded * * * but the exercise of the right is not the performance of a governmental function, and must find its support in some authority apart from the police power. When a State enters the market place seeking customers it divests itself of its quasi sovereignty *pro tanto,* and takes on the character of a trader, so far, at least, as the taxing power of the federal government is concerned."

In *Helvering* v. *Powers* the compensation of the trustees of the Boston Elevated Railroad Company appointed by the State of Massachusetts was held to be taxable under the Federal income tax law. The Boston Elevated was a wholly-owned private corporation which had gotten into serious financial difficulties. On account of the importance of the enterprise the State temporarily took over its operation

through three trustees. From the gross receipts, all costs of operation, "of which the compensation of the trustees is undoubtedly a part" (p. 223), and a sum equal to the dividends upon the preferred stock sold by the company to raise funds to enable the State to carry on, were to be paid. When all deficits incurred under State operation had been made good from earnings, it was provided the company should be turned back to private control. The Court commented on the fact that the railroad property remained "*in private ownership*" (p. 223); that the salaries paid the trustees were a charge against the company; and that the State had engaged in business which constituted "*a departure from usual Governmental functions.*" It therefore applied the doctrine of the dispensary cases.

In these latter cases, while the question of predominancy was not discussed nor decided as in *Osborn* v. *United States Bank,* it seems to be a fair implication that it was assumed. The distinction to be drawn from all the cases, therefore, is that where the main purpose is to enter the field of private commerce as a trader, the immunity from taxation is lost; but where the main purpose is in fact governmental and commercial activity is only incidental, it remains.

It has become customary, in dealing with the question here presented, to regard the States and the Federal Government upon an exact parity with each other; but that was not the original position of this Court. Thus, in *M'Culloch* v. *Maryland,* Chief Justice Marshall said at page 425:

> "The two cases are not upon the same reason. The people of all the states have created the general government, and have conferred upon it the general power of taxation. The people of all the states, and the states themselves, are represented in Congress, and, by their representatives, exercise this power. When they tax the chartered institutions of the states, they tax their constituents; and these taxes must be uniform. But when a state taxes the operations of the Government of the United States, it acts upon institutions created, not by their own constituents, but by the people over whom they claim no control. It acts upon the meas-

> ures of a government created by others as well as themselves. The difference is that which exists, and always must exist, between the action of the whole on a part, and the action of a part upon the whole—between the laws of a government declared to be supreme, and those of a government which, when in opposition to those laws, is not supreme."

But whether or not this doctrine of supremacy is to be given full force and effect there is undoubtedly a difference between State and central government in regard to this question. The United States, being exclusively a government of delegated powers, has no authority under the Constitution to engage in any form of private business. As said by Justice Gray, delivering the opinion of the Supreme Court in *Van Brocklin* v. *Tennessee*, 117 U. S. 151, 155, 158:

> "The United States do not and cannot hold property, as a monarch may, for private or personal purposes. All property must be held, just as taxes are levied, to pay the debts and provide for the common defense and general welfare of the United States."

The United States, under the Constitution, therefore, stands in an entirely different posture from the States or their municipalities, which possess two powers, one governmental and public (e. g., the maintenance of streets and roads) and the other private (e. g., the operation of a transportation system). See *Lloyd* v. *Mayor*, 5 N. Y. 369, 374. The United States has no choice; all property held by it must be held in a governmental capacity; otherwise, it is held in the teeth of the law. To illustrate: the Canal charges tolls as any private carrier, earns profits, and competes with the transcontinental railroads. But can there be any doubt that in its construction and operation the central government is exercising a governmental, and even an ordinary governmental function? If not, and it be looked upon as a private undertaking, the Federal control of the Canal becomes a mere usurpation in defiance of the law.

This distinction should be borne in mind in considering the effect of cases like *South Carolina* v. *United States*, 199

U. S. 437; *Ohio* v. *Helvering*, 292 U. S. 360; and *Helvering* v. *Powers*, 293 U. S. 214; upon which the decision of the Appellate Division was rested. In these cases it was held that the State or one of its subdivisions engaged in business as a private trader; and therefore sacrificed its ordinary immunity from Federal taxation. The States may do that very thing. The Federal Government cannot. There is not room for the distinction between the Panama Rail Road Company as a governmental agency and the Panama Rail Road Company as a private enterprise; a distinction only available in State cases. In owning the railroad and operating it as it does, the Government is proceeding within governmental lines, or it is proceeding *ultra vires* and without warrant of law. The conclusion that it is proceeding beyond its powers, it is submitted, may not be indulged.

IV.

Panama Rail Road salaries are in substance Government salaries.

In conclusion, attention should be called to the fact that the relator, as well as other employees of the Panama Rail Road Company, while not *direct* employees of the United States Government, according to the acts of Congress cited on pages 8 and 9 of this brief, are in substance such. If so, they would seem to fall within the exception from state taxation of "salaries, wages and other compensation received from the United States of officials or employees thereof," made by Section 359-f of the New York Tax Law itself, and judgment should have been rendered for appellant upon that ground.

Respectfully submitted,

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